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The Influence Of Long-Term Tangıble Asset's Valuatıon On Fınancıal Indıcators: The Attıtude Of Shareholders And Credıtors

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Abstract

In the article the long-term tangible asset's valuation methods by the historical cost and the fair value are generalized, indicators that are analyzed by shareholders and creditors when assessing the company's financial condition are identified. For the research eight Lithuanian companies which apply different long-term tangible asset's valuation methods were selected from two industries. The influence of long-term tangible asset's valuation was explored by five relative indicators. It was determined that valuation method is associated with long-term tangible asset's part in the total company's asset. When long-term tangible asset's part in the total company's asset constitutes less than 50 percent, the asset's valuation method has no influence on the analyzed indicators. When long-term tangible asset's part in the total asset constitutes more than 50 percent, the asset's valuation method affects solvency and investment indicators. Long-term tangible asset's valuation method does not affect profitability indicators, independent of long-term tangible asset's part in the total asset.

Keywords: Long-term tangible asset, valuation, financial indicators

Introduction

When disposing the long-term tangible asset, its valuation is an important task of accounting in order objectively to reflect financial condition of business entities. Depending on the type of the asset, different valuation methods based on the historical cost and the fair value can be applied.

Alternatives of valuation methods gives a possible of manipulating indicators reflecting the long-term tangible asset's value – often an actual value of business entities' asset may significantly vary from the one indicated in the balance sheet. The more the actual long-term tangible asset's value differs from the value indicated in accounting documents, the more

data of financial accountability is distorted and therefore users of financial accountability (shareholders and creditors) may incorrectly evaluate financial condition of the business entity and make wrong economic decisions. In order to give the most precise information about financial condition of business entities in financial statements, it is necessary to explore the influence of long-term tangible asset's valuation method on financial indicators.

Scientific problem – what influence the long-term tangible asset's valuation method has on financial indicators of business entities.

Research object – long-term tangible asset's valuation.

The aim of the research – after analyzing theoretical aspects of long-term tangible asset's valuation, to explore the influence of long-term tangible asset's valuation methods on financial indicators analyzed by shareholders and creditors.

Objectives of the research

1. To generalize researchers' approaches to methods of long-term tangible asset's valuation by the historical cost and the fair value, revealing differences of valuation methods.
2. To identify relative indicators used by shareholders and creditors when valuating company's financial condition.
3. To explore the influence of long-term tangible asset's valuation methods on financial indicators of selected Lithuanian companies.

The long-term tangible asset's valuation by the historical cost and the fair value

Each company disposes the long-term tangible asset of greater or lesser value. According to 12 BAS (Business accounting standard) "Non-current tangible assets" is such tangible asset:

a) which is designed for production of goods, provision of services, lease or administrative purposes;

b) which is intended to be used for more than one year;

c) which historical (production) cost is not less than the minimum of the long-term tangible asset's unit value set by the company.

This standard indicates that the number of asset's groups and types company determines at its discretion. Each group of the asset must be valued in accordance with generally accepted accounting principles and business accounting standards or international accounting standards.

Valuation in accounting can be defined as determination process of the value at which elements of financial statements are presented in financial statements (Brinza, Badoi, 2013).

There are distinguished two methods of valuation – the historical cost and the fair value. According to 12 BAS long-term tangible asset, with the exception of investment, after its acquisition or production is valuated in the accounting by the acquisition (production) cost, then, according to the company's accounting policy, it can be accounted in one of the following methods:

1. historical cost;
2. revalued value.

The different accounting methods can be applied to valuation of particular groups of the asset. Revaluation of the long-term tangible asset is perceived as valuation at the fair value, because when revaluating the asset, its balance value is increased (or reduced) to the fair value of that asset.

The scientific literature indicates that the main goal of **the historical cost method** is correctly to value the asset attributing to the asset's value all basic costs associated with its acquisition and production (Sing, Meng, 2005; Elad, 2007, Zeff, 2007; Ryan, 2009; Bonaci, Strouhal, 2011). Diewert (1996) considers method of the historical (production) cost as the primary and most widely used in practice. However, this method is based on the assumption that there is no inflation in the economy or inflation is ignored. As accounting disadvantages of historical costs, when prices are changing, are identified and other reasons, such as:

1) specific change in the price level (changes in customers' priorities, technological advantages);

2) fluctuations of interest rate.

The scientific literature suggests that **the fair value** is the sum for which the asset could be exchanged between unrelated counterparties who wish to buy or sell the asset. The fair value is associated with the market price. For asset's valuation at the fair value, an active market is necessary (Sing, Meng, 2005; Nissim, Penman, 2008; Ristea, Jianu, 2010; Enahoro, Jayeoba 2013). Scott (2002) argued that the fair value emerged as a result of satisfaction of accounting information users' needs. Application of the fair value method is an opportunity correctly to determine the value of long-term tangible asset.

Bonaca, Strouhal (2011) claims that the fair value method is more perspective because the asset indicated in the balance sheet valuated at the fair value corresponds to the actual value of the asset at the date of formation of financial statements. The fair value reflects current market conditions, therefore, provides timely information about processes in the market, and enhances clarity and transparency of the market. Wang (2012) claims, that the asset valuation at the fair value is significant for creditors' and shareholders' decisions, because this valuation method reflects company's real financial condition. The historical cost method also affects economic

decision-making as long as the accounting value reasonably reflects the fair value. When the historical cost deviates from the fair value, the influence on economic decision-making based on the historical cost decreases.

After analyzing literature, it was noticed that many researchers offer the fair value method to be used for companies which have a lot of long-term tangible asset with a long usage time and which value in the market changes frequently. In their view, long-term tangible asset's valuation at the fair value can give more accurate valuation of company's financial indicators and help to make right economic decisions.

Relative indicators analyzed by shareholders and creditors when assessing company's financial condition

According to Firescu (2013) an accounting is defined by two paradigms:

- ✓ valuation tool paradigm,
- ✓ information tool paradigm.

In the first paradigm the accounting is equated with valuation of financial statements' elements. The second paradigm states that the aim of financial accounting is to provide correct information to users of financial statements' information for making economic decisions (decisions' usefulness approach).

Internal and external users of financial statements' information are distinguished. Internal users include executives, shareholders and employees. External users include investors, creditors, customers, competitors, public authorities and society.

Shareholders are interested in correct financial statements' information, because it is important for them to know results of their investments in the company and impact of management's activities on increasing shares' value (Nissim, Penman, 2008).

The maximum value is one of the most important objectives for shareholders in profit seeking companies (Saliha, Abdessato, 2011). Authors variously define the value for shareholders. Rappaport (1998) claims that the value for shareholders is company's equity capital's balance sheet value which can be measured by subtracting liabilities from the asset. Scott (1998) and Serven (1999) suggest that the value for shareholders is company's equity market value (company's capitalization sum) which is calculated by multiplying the number of ordinary shares by the share's average market price. When determining the value for shareholders usually profitability, liquidity, solvency, turnover and investment indicators are analyzed. Relative indicators in performed researches were divided into two groups: 1) accounting based, 2) market based. Traditional accounting based indicators were criticized because they are not effective when making economic decisions. These deficiencies were eliminated by calculating market based

financial indicators (Sandoval, 2001). Relative indicators commonly used by shareholders are shown in Table 1.

Company's ability timely to repay debts and to pay interest is important to ***creditors***. Debt is the main external source of financing in the capital market, therefore accounting information is significant to creditors. According to Armstrong et al. (2010), creditors require information provided by financial accountability for decision making and lending purposes. Financial accountability for creditors provides information about debtor's risk level, profitability, efficiency of management and company's deposit evaluation. According to Christensen, Nikolaev (2010) company's profitability, liquidity and solvency indicators are the main indicators for the creditors. Relative indicators commonly used by creditors are shown in Table 1.

Table 1 Relative indicators used by shareholders and creditors

Ref. No.	Relative indicators	Calculation	Used by shareholders	Used by creditors
	Accounting based			
1.	Profitability indicators			
	Net profit ratio	The net profit / sales income	X	
	Operating profit, ROS	Operating profit / sales income	X	
	Return on assets, ROA	The net profit / asset	X	X
	Return on equity, ROE	The net profit / equity capital	X	X
2.	Liquidity indicators			
	Current ratio	Current asset / current liabilities	X	X
	Quick ratio	(Current asset - stocks) / current liabilities	X	X
3.	Solvency indicators			
	Debt ratio	Liabilities / asset	X	X
	Debt-to-equity ratio	Liabilities / equity capital	X	X
	Times interest earned, TIE	Operating profit / interest		X
	Debt/ EBITDA	Debts/ EBITDA		X
4.	Turnover indicators			
	Inventory turnover ratio	Sales historical cost/ stocks	X	
	Asset turnover	Sales revenue/ asset	X	
	Market based			
5.	Capital market indicators			
	Earnings per share, EPS	The net profit / number of ordinary shares	X	
	Dividend payout ratio	Dividends / the net profit	X	
	Price to earnings ratio, P/E	Shares market price / the net profit per share	X	
	Price book value ratio, P/BV	Capitalisation (the company's market value) / equity capital	X	X
	Tobin's q ratio, Tq	Capitalisation (the company's market value) / replacement asset value	X	

Table 1 shows that shareholders and creditors can analyze both different and the same relative indicators when making economic decisions. According to the information provided in the table there are distinguished relative indicators which are analyzed both by shareholders and creditors when making economic decisions. These are return on assets (ROA), return on equity (ROE), current ratio, quick ratio, debt ratio, debt-to-equity ratio, price book value ratio.

Return on assets (ROA) indicates how efficiently company's asset is managed and used to earn income. Shareholders and creditors give preference to a greater indicator (Palepu et al., 2010).

Return on equity (ROE) shows how effectively shareholders' funds are used. This indicator highly depends on the company's capital structure. The more company aims to maximize shareholders' value, the greater ROE should be. High ROE shows effective management of equity capital, as well as higher returns for investors. This indicator is recommended to be analyzed in conjunction with asset's profitability indicator (Livingstone, Grossman, 2002).

Current ratio shows company's ability to cover current liabilities with current asset. **Quick ratio** shows company's ability quickly to cover current liabilities with current asset, thereto stocks, as low liquid asset, are deducted from current asset (Palepu et al., 2010).

Debt ratio compares company's debt with its total asset. The lower the value of the indicator, the more debts are covered by the asset, therefore creditors prefer low value of this indicator. Companies with low debt ratio are more valued in the stock market. A higher ratio shows an increased risk of company's insolvency (Lakshan, Wijekoon 2013).

Debt-to-equity ratio compares company's debt with shareholders' equity. A higher ratio indicates worse company's solvency. If the ratio is greater than 1, this indicates that most of the company's asset is financed with lent funds. If the ratio is less than 1, this indicates that the asset is mainly funded by equity (Lakshan, Wijekoon 2013).

Price book value ratio value is associated with a change of share's market price. This ratio shows how much an investor is willing to pay per share, compared with its book value. Lower proportion means cheaper share (Dunis, Reilly, 2004).

Summarizing it can be stated that shareholders and creditors when making economic decisions can analyze both different and the same relative indicators. Since users of financial statements' information are interested in the correct information about company's financial condition, it is important to determine whether long-term tangible asset's valuation method influences financial indicators analyzed by shareholders and creditors.

Research stages and results

In order to determine whether long-term tangible asst's valuation method influences financial indicators analyzed by shareholders and creditors, a research, consisting of 3 stages, was conducted:

1. To select companies for the research,
2. To determine financial indicators influenced by long-term tangible asset's valuation method,
3. To compare average values of researched companies' financial indicators influenced by long-term tangible asset's valuation method, when long-term tangible asset is valued by different methods.

1st stage of the research. Companies for the research were selected according to industry, long-term tangible asset's valuation method and average part of long-term tangible asset in the total asset during 2011-2014. For the research eight companies from two different industries were selected from Lithuanian Stock Exchange Main List and Secondary List. For the research those industries were selected to which belonging companies have different part of long-term tangible asset in the total asset. In researched milk products manufacturing companies a part of long-term tangible asset in the total asset during 2011-2014 on average amounted 37.4 percent and in public utilities companies - 79.6 percent. In each industry two companies were selected which value long-term tangible asset at the historical cost and two companies which value long-term tangible asset at the revalued value. Information about companies selected for the research is presented in Table 2.

At this stage, two research restrictions were distinguished:

1) small sample size. Currently there are 28 companies in Lithuanian Stock Exchange Main List and Secondary List which during 2011-2014 financial reports made publicly available. Only 10 of these companies from different industries value long-term tangible asset at revalued value (3 public utilities companies, 2 milk products manufacturing companies, 2 construction services companies, 1 alcoholic drink production company, 1 retail trade company and 1 agricultural company), other companies apply historical cost. Therefore, it was difficult to select those companies and industries that can be compared with each other.

2) calculation of the average of long-term tangible asset's part in the total asset. In researched milk products manufacturing companies that apply different long-term tangible asset's valuation methods, long-term tangible asset's part in the total asset sufficiently differ from the average rate. Therefore, these fluctuations partly limit accuracy of the results obtained.

Table 2 Long-term tangible asset's valuation methods and long-term tangible asset's part in the total asset in researched Lithuanian companies during 2011-2014

Ref. No.	Company	Industry	Long-term tangible asset's valuation method	Long-term tangible asset's part in the total asset on the average during 2011-2014
1.	Žemaitijos pienas	Milk products manufacturing	Historical cost	37,4 per cent
2.	Vilkyškių pieninė		Historical cost	
3.	Pieno žvaigždės		Revalued value	
4.	Rokiškio sūris		Revalued value	
5.	Lietuvos dujos	Public utilities	Historical cost	79,6 per cent
6.	Kauno energija		Historical cost	
7.	Lietuvos energija		Revalued value	
8.	Litgrid		Revalued value	

2nd stage of the research. For exploration of long-term tangible asset's valuation's influence on financial indicators 5 relative indicators, analyzed by shareholders and creditors when making economic decisions, were selected: return on assets (ROA), return on equity (ROE), debt ratio, debt-to-equity ratio, price book value ratio. Current ratio and quick ratio were excluded, because they are used to calculate the value of the current asset. Relative indicators of selected for the research Lithuanian companies presented in Table 3.

Table 3 Relative indicators of researched Lithuanian companies

Ref. No.	Company	2011	2012	2013	2014
1.	Return on assets (ROA), percent				
	Žemaitijos pienas	4,24	10,82	9,16	4,32
	Vilkyškių pieninė	11,01	3,61	12,91	3,89
	Pieno žvaigždės	7,7	8,61	2,72	5,53
	Rokiškio sūris	3,47	5,01	14,8	-4,4
	Lietuvos dujos	3,55	2,59	-12,46	19,67
	Kauno energija	3,23	0,19	0,67	0,59
	Lietuvos energija	0,29	0,88	2,91	3,44
	Litgrid	-0,82	1,08	1,22	-21,35
2.	Return on equity (ROE), percent				
	Žemaitijos pienas	7,15	15,22	12,1	5,86
	Vilkyškių pieninė	27,11	10,07	29,87	8,46
	Pieno žvaigždės	17,37	19,57	7,51	12,51
	Rokiškio sūris	5,57	7,42	19,54	-6,96
	Lietuvos dujos	4,66	3,69	-19,97	25,58
	Kauno energija	4,91	0,32	1,13	1,11
	Lietuvos energija	0,65	1,99	6,87	8,56
	Litgrid	-1,07	1,66	1,85	-46,96
3.	Debt ratio				

	Žemaitijos pienas	0,41	0,29	0,24	0,26
	Vilkyškių pieninė	0,59	0,64	0,57	0,54
	Pieno žvaigždės	0,56	0,56	0,64	0,56
	Rokiškio sūris	0,38	0,32	0,35	0,27
	Lietuvos dujos	0,24	0,3	0,38	0,23
	Kauno energija	0,34	0,41	0,41	0,47
	Lietuvos energija	0,55	0,56	0,58	0,6
	Litgrid	0,24	0,35	0,34	0,55
4.	Debt-to-equity ratio				
	Žemaitijos pienas	0,69	0,41	0,32	0,36
	Vilkyškių pieninė	1,46	1,79	1,31	1,18
	Pieno žvaigždės	1,26	1,27	1,77	1,26
	Rokiškio sūris	0,38	0,32	0,35	0,27
	Lietuvos dujos	0,31	0,42	0,6	0,3
	Kauno energija	0,52	0,7	0,69	0,87
	Lietuvos energija	1,23	1,26	1,36	1,49
	Litgrid	0,31	0,54	0,52	1,2
5.	Price book value ratio				
	Žemaitijos pienas	0,85	0,69	0,8	0,69
	Vilkyškių pieninė	0,99	0,99	0,91	1,07
	Pieno žvaigždės	1,95	2,02	2,43	1,95
	Rokiškio sūris	0,6	0,65	0,6	0,57
	Lietuvos dujos	0,14	0,14	0,34	0,33
	Kauno energija	0,19	0,32	0,33	0,27
	Lietuvos energija	0,48	0,51	0,61	1,38
	Litgrid	0,37	0,59	0,66	1,43

Summarizing data from Table 3, it can be concluded that profitability ratios (ROA and ROE) of milk products manufacturing companies were higher than the ones of public utilities companies. Researched milk products manufacturing companies which value long-term tangible asset at the historical cost, profitability indicators were slightly higher than those of companies which apply the revalued value. Debt ratio in companies of both industries ranged about 0.5, which indicates that researched companies' debts were covered by the asset. Debt-to-equity ratio in companies fluctuate differently, but in most companies it was higher than 0.5. This indicates that solvency of companies was not good. Milk products manufacturing companies' price book value ratio was higher than of public utilities companies. Therefore, it can be concluded that shares of milk products manufacturing companies were more expensive than the ones of public utilities companies. Extremely high shares market price was of AB „Pieno žvaigždės". Share market price of this company was almost twice higher than the book value.

After calculating and analyzing relative indicators of researched companies such hypotheses can be formulated:

H_0 – long-term tangible asset's valuation method has no influence on relative indicators,

H_1 – long-term tangible asset's valuation method has influence on relative indicators.

Hypotheses of this research were tested by SPSS 17 program. For verification of hypotheses statistical test was used – a rule according to which, based on sample data, the hypothesis H_0 is accepted or rejected. Significance level α is equal to 0.05. Hypotheses were tested using the p-value method. According to p-value it is decided whether to reject the hypothesis H_0. If $p<0.05$, H_0 is rejected, and the possibility to make a mistake, rejecting the correct hypothesis, is equal to p.

Hypotheses testing results are presented in Table 4.

Table 4 Results of hypotheses testing using p-value method

Ref. No.	Indicators	Industry	
		Milk products manufacturing	Public utilities
		p-value	
	Accounting based		
1.	Return on assets (ROA)	0,399	0,382
2.	Return on equity (ROE)	0,374	0,449
3.	Debt ratio	0,871	*0,049*
4.	Debt-to-equity ratio	0,786	*0,033*
	Market based		
5.	Price book value ratio	0,144	*0,011*

After analyzing the data provided in Table 4, it can be stated that in companies from milk products manufacturing sector where long-term tangible asset's part in the total asset constitutes less than 50 percent, valuation method has no influence on selected relative indicators. It is indicated by p-values which are higher than the significance level of 0.05. In this case, it can be concluded that the hypothesis H_0 cannot be rejected.

In companies from public utilities sector long-term tangible asset's part in the total asset constitutes more than 50 percent. Long-term tangible asset's valuation method has no influence on return on assets (ROA) and return on equity (ROE) of companies from this sector. But it has influence on debt ratio, debt-to-equity ratio and price book value ratio. It is indicated by p-values which are less than the significance level of 0.05 and the hypothesis H_0 can be rejected.

In **3rd stage of the research** average values of researched companies' financial indicators during 2011-2014 which were influenced by long-term tangible asset's valuation method were compared, when long-term tangible asset is valued by different methods. Results of this stage, presented in Table 5, shows that average rates of selected for this research public utilities companies, when long-term tangible asset is valued at the revalued value,

were higher than those of companies in which the long-term tangible asset is valued at the historical cost. Therefore, it can be concluded that:

1) *situation* of researched public utilities companies where long-term tangible asset is valued at the revalued value, *in respect of the solvency, is worse* than of companies where long-term tangible asset is valued at the historical cost,

2) *shares* of researched public utilities companies where long-term tangible asset is valued at the revalued value *are more expensive* than of companies where long-term tangible asset is valued at the historical cost.

Table 5 Average values of researched public utilities companies' indicators affected by the long-term tangible asset's valuation method

Ref. No.	Long-term tangible asset's valuation method	Indicator's average value during 2011-2014	Indicator's interpretation
1.	Debt ratio		
	Historical cost	0,35	A higher ratio value indicates increased risk of insolvency.
	Revalued value	*0,47*	
2.	Debt-to-equity ratio		
	Historical cost	0,55	Higher ratio value indicates worse company's position with respect to its solvency.
	Revalued value	*0,99*	
3.	Price book value ratio		
	Historical cost	0,26	Higher ratio value indicates more expensive share.
	Revalued value	*0,75*	

Summarizing the data obtained during the research, it can be concluded that the valuation method is associated with long-term tangible asset's part in the total company's asset. When long-term tangible asset's part in the total asset constitutes less than 50 percent, the asset valuation method has no influence on analyzed financial indicators. When long-term tangible asset's part in the total asset constitutes more than 50 percent, the asset valuation method affects indicators of solvency and investment. Long-term tangible asset's valuation method, regardless of the part of long-term tangible asset in the total asset of the company, does not affect profitability indicators (ROA and ROE). The results showed that in researched public utilities companies where long-term tangible asset is valued at the revalued value, average indicators of solvency and investment are higher than in companies where long-term tangible asset is valued at the historical cost.

Conclusion

There are distinguished two methods of asset's valuation based on the historical cost and the fair value, which differ in reliability level. Applying historical cost method, the asset is valued by assigning to asset's value all

main expenses related to its acquisition and production. The fair value is associated with the market price. This is the sum for which an asset could be exchanged between unrelated counterparties who wish to buy or sell the asset. The fair value method is more perspective because the asset presented in the balance sheet valued at the fair value corresponds to the actual value of the asset at the date of formation of financial statements, therefore, when applying this method, financial indicators are calculated more accurately and more correct economic decisions are made.

Shareholders and creditors are interested in correct information of financial statements. It is important for shareholders to know results of their investments in company. For creditors company's ability timely to repay debts and to pay interests is important. The research distinguished financial indicators that are analyzed by shareholders and creditors when making economic decisions. These are return on assets (ROA), return on equity (ROE), current ratio, quick ratio, debt ratio, debt-to-equity ratio, price book value ratio.

The research showed that valuation method is associated with long-term tangible asset's part in the total company's asset. When long-term tangible asset's part in the total asset constitutes less than 50 percent, the asset valuation method does not affect analyzed financial indicators. When long-term tangible asset's part in the total asset constitutes more than 50 percent, the asset valuation method affects indicators of solvency and investment. Long-term tangible asset's valuation method, regardless of the part of long-term tangible asset in the total assets of the company, does not affect profitability indicators.

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